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SENATE

STANDING COMMITTEE ON ECONOMICS

Reference: Price of petrol in Australia

FRIDAY, 13 OCTOBER 2006

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**SENATE STANDING COMMITTEE ON
ECONOMICS**

Friday, 13 October 2006

Members: Senator Brandis (*Chair*), Senator Stephens (*Deputy Chair*), Senators Bernardi, Chapman, Joyce, Lundy, Murray and Webber

Substitute members: Senator O'Brien for Senator Webber

Participating members: Senators Adams, Allison, Barnett, Bartlett, Boswell, Bob Brown, George Campbell, Carr, Conroy, Eggleston, Chris Evans, Faulkner, Ferguson, Ferris, Fielding, Fifield, Forshaw, Hogg, Kirk, Lightfoot, Ludwig, Marshall, Ian Macdonald, McGauran, Mason, Milne, Nettle, O'Brien, Parry, Payne, Robert Ray, Sherry, Siewert, Watson and Wong

Senators in attendance: Senators Brandis, Murray, O'Brien, Parry and Stephens

Terms of reference for the inquiry:

To inquire into and report on:

The price of petrol in Australia, with particular reference to:

- (a) the relationship between the landed price of crude oil, refining costs, the wholesale price and the retail price of petrol;
- (b) regional differences in the retail price of petrol;
- (c) variations in the retail price of petrol at particular times;
- (d) the industry's integrated structure; and
- (e) any other related matters.

WITNESSES

BEATTIE, Mr Richard, Group Manager, Corporate Affairs, Caltex Australia 1

JOHNSON, Mr Peter, Policy Adviser, Australian Chamber of Commerce and Industry 27

KING, Mr Desmond, Managing Director and Chief Executive Officer, Caltex Australia..... 1

**POTTER, Mr Michael, Director, Economics and Taxation, Australian Chamber of Commerce
and Industry 27**

RIDLEY-SMITH, Mr Michael, National Fuels Marketing Manager, Caltex Australia 1

Committee met at 9.04 am**BEATTIE, Mr Richard, Group Manager, Corporate Affairs, Caltex Australia****KING, Mr Desmond, Managing Director and Chief Executive Officer, Caltex Australia****RIDLEY-SMITH, Mr Michael, National Fuels Marketing Manager, Caltex Australia**

CHAIR (Senator Brandis)—Good morning. I declare open this hearing of the Senate Standing Committee on Economics. Today the committee will resume its hearings in relation to petrol pricing in Australia. We will be hearing evidence from Caltex and the Australian Chamber of Commerce and Industry. As presently intended, this will be the penultimate hearing, the last being with the Australian Competition and Consumer Commission next Thursday. These are public proceedings, although the committee may agree to a request to have evidence heard in camera or may determine that certain evidence should be heard in camera.

I remind all witnesses that in giving evidence to the committee they are protected by parliamentary privilege. It is unlawful for anyone to threaten or disadvantage a witness on account of evidence given to a committee and such action may be treated by the Senate as a contempt. It is also a contempt to give false or misleading evidence to a committee of the parliament. If a witness objects to answering a question the witness should state the ground upon which the objection is made and the committee will determine whether it will insist on an answer having regard to the ground which is claimed. If the committee determines to insist on an answer, a witness may request that the answer be given in camera. Such a request may, of course, also be made at any other time.

Gentlemen, the committee has received your submission number 55 together with the confidential attachment and I understand we are also to see a presentation from you, the slides of which have also been supplied to us. I suspect, Mr King, what you want to do is in the form of the opening statement take us through your presentation—is that right?

Mr King—That is correct, at least a summary of it.

CHAIR—That is fine. I invite you to do that.

Mr King—Thank you for the opportunity to meet with the committee today and to present Caltex's position on the price of petrol in Australia. I would like to briefly explain where Caltex sits in the Australian oil refining and marketing industry, how our position is significantly different from our global major competitors and then run through what we think are the most important comments we made in our submission. Because the comments I would like to make have been extracted from the Caltex submission to this inquiry, the chart numbers in the document we have handed out this morning refer to the charts in the submission.

CHAIR—Mr King, I see there is a television cameraman in the room which is fine, but I take it that in your presentation you will not require to go to the material you have given to us on a confidential basis. If you wish to do that, could you give us reasonable advance notice so we can have the room cleared of the media?

Mr King—We would be happy to do so. Our summary does not go into the information that would need to be in camera, but if some of the questions require us to share more confidential information we will make that request.

CHAIR—Thank you.

Mr King—I understand that the committee members may wish to ask questions on our material and obviously please feel free to do so. Let me give you some background on Caltex, its structure and its operations. Caltex Australia Ltd is Australia's leading refiner and marketer of petroleum products which are sold under the Caltex, Caltex Woolworths and Ampol brands. Caltex is the only major refiner and marketer listed on the Australian Stock Exchange. Chevron Corporation of the US is a 50 per cent shareholder but Caltex is not a subsidiary and all decisions are made by Caltex, its Australian board and management.

Caltex is engaged in refining and marketing only and has no exploration or production interests nor any overseas refining or marketing operations. We have to buy all our crude on the world market at world prices, regardless of whether it comes from Asia, the Middle East or Australia. Caltex has two refineries: one in Sydney; which is Kurnell, and one in Brisbane, which is Lytton and has as of 31 December 2005 owned or leased 546 service stations within a network of about 1,900 branded service stations and Caltex has about 3,000 employees.

Caltex's average profit on replacement cost of production basis, which excludes the effect of crude oil price movements or inventory so Caltex's average profit on that basis across all petroleum products including petrol, in 2005 was 2.2c per litre after tax. The profit for the first half of 2006 on the same basis equated to 1.8c per litre on average for all petroleum products and, by comparison, for the first half of 2005 the figure is 1.7c per litre.

Unlike our major competitors, Caltex Australia's focus is entirely on refining and marketing in Australia, and the global majors have their primary focus on oil and gas exploration and production—their capital allocation is focused on exploration and production. I am very pleased to have the opportunity to lead a company where our sole focus and capital allocation is on refining and marketing in Australia ensuring a secure supply of transport fuels and lubricants for the country. Our vision is to be the Australian oil refining and marketing company most admired for its people, partnership and performance. I will now lead you through some of the key points in the presentation we submitted.

CHAIR—This might be a little bit wearisome but, in order to get it clear on the *Hansard*, if you are going to refer us to charts or tables would you mind just nominating the chart number or table number so that it will be clear what you are talking about.

Mr King—Yes, I will be happy to do that. There are charts in the document we submitted—the original plus the supplement or the precis—but we also will show some of those charts on the screen, which we can provide to you later updated to current information. So you will see the whole story since the submission was made three months ago to give you updated information on the same chart.

CHAIR—Will you give us that in hard copy as a supplementary?

Mr King—We will indeed; we will make it very clear. The first chart I would like to refer the committee to is chart 12 in the original submission as well as the precis document. We put up on the screen an update of that chart—chart 12A as we will call it—which updates that information through to the current day, which is the last three months of information since the submission. This chart shows the Singapore petrol price, which forms the benchmark of prices in Australia plus freight, plus quality premium, plus excise—in other words, this is the landed cost of petrol in Australia versus the average national Caltex terminal gate price, and these are all excluding GST.

CHAIR—By the way, Mr King, I wish to indicate to other senators that I think we will do with these witnesses what we have done during previous witnesses who have had presentations—that is, if you have got questions about the charts, just jump in.

Mr King—So if we look at the trends of these you can see that the average national Caltex TGP and the Singapore petrol price adjusted for freight—the Australian quality premium because of our high quality fuel here plus excise—follows very much the same trends.

CHAIR—Where do we find in that chart what is described by some people as the refiners' margin?

Mr King—The refiners' margin is not actually included in that chart. The refiners' margin is the petrol price minus the raw material or crude oil price so that is not demonstrated here. We will actually show that though.

CHAIR—Thank you.

Mr King—So this chart shows the trends and, as you can see, it has been updated since the submission to go through to the current day. Petrol prices have dropped considerably in Singapore, and the TGP has also followed that same trend. The key point we would like to make with this chart is that Australian petrol prices are based on import parity prices for Singapore petrol.

The next chart I would like to refer to is chart 4 in the original submission, which in your precis document is chart 4A and what we have on the board here. This goes to the issue that you were talking about. This is the daily Singapore petrol price versus the crude oil price. As you can see, the petrol price is the yellow line in Singapore; the crude oil price in Australian cents per litre is based on Tapis crude, which is Malaysian crude and a benchmark crude for this region. You can see that they have a similar trend but not identical trends, so they are linked but distinct. The point we would like to make with this chart is that Singapore prices are certainly related to crude oil prices, but the petrol market and the crude oil market are two very distinct markets traded separately.

As you can see, talking about refiners' margins, currently the price of petrol in Singapore is less than the price of crude oil. That means that for every litre of petrol produced in Singapore they are losing money compared to the cost of the crude that they are buying. At other times it is positive, and obviously it needs to be positive or otherwise there would not be a business case for having a refinery. One can see in the trends that they are in general the same shape, but they

are not linked. Sometimes petrol goes below crude and at other times it goes above crude. Overall it is above crude; hence there is a business case for having a refinery.

CHAIR—The horizontal scale calibrates this on a fortnightly basis. Is there a lag of a day or two between the dark line and the yellow line?

Mr King—These actual data points are for Singapore and they are on a day-by-day basis. So this is based on Singapore rather than any lag to get to Australia.

CHAIR—I see.

Senator MURRAY—But there surely would not be a symmetry between those two lines, because crude oil takes a while to refine and distribute, whereas petrol cargo is an immediate item, isn't it?

Mr King—It is. It takes time to deliver to Australia, but certainly in Singapore the posted price is that day for crude. If the refiner goes out and buys crude for delivery that day, that is what it costs. Certainly there may be, if the crude came from Malaysia, a few days to get to the refinery.

Senator MURRAY—My question is this, really. Let's assume you were delivering—let's just pick a city—to Brisbane. You deliver the crude to Brisbane and there is a time period during which it has to be refined and converted to petrol. If you buy a refined product, it is available for immediate distribution, so surely those prices would vary as a result.

Mr King—It takes time to distribute product from local refineries, but since about 25 per cent of all product used in Australia is imported there is a similar delay for supplying that product to market in Australia to supplying the crude for refineries in Australia.

If we move on to chart 6 in the original submission or chart 6A in the supplemental submission, this goes to the point, Mr Chairman, you were mentioning about refiner margins. As you can see, this is in US dollars per barrel from 1998 through to the current day, and you can see that certainly much of the time the purple line, the margins, are above zero, but there are times like currently, when the margin is negative for petrol. So petrol basically is worth less than crude oil. The margin is the value of the product minus the value of the raw material, the crude. Taken out of that margin has to be all the operating costs, wages and so on of the people who work in the refineries. So one needs a reasonable margin to be able to break even and certainly at times when the margin is negative one could imply that there is less than break-even performance financially of those refineries.

CHAIR—So this is a gross margin?

Mr King—That is correct. Looking at this margin reinforces that product prices and crude prices are not directly linked. Otherwise, the number would always be positive.

The next summary point we would like to make refers to (b) in the terms of reference, and I refer you to chart 15 in the original submission, which is also chart 15 in the precis submission. On the screen we have updated it to the current day to have the last three months of information.

What this shows is the average New South Wales regional pump price versus the Sydney TGP. It shows metro, regional and terminal gate price all on one chart. The point we wish to make with this chart is that the metropolitan and regional pump prices do closely follow the terminal gate prices. You can see a very distinct trend. It is linked.

CHAIR—You say ‘average regional price’, but are the Sydney prices an average as well, because the prices are not uniform across Sydney, are they?

Mr King—They are both averages. As we said earlier, the TGP itself closely follows the Singapore petrol price trends, as indicated in the previous charts, 12 or 12A. The point we wish to make here is that, indeed, metropolitan and regional pump prices do closely follow terminal gate prices, which themselves are then linked back to the Singapore price.

The other summary point we would like to make is on price cycles, and I refer the committee to chart 24 in the original document, which is also chart 24 in the precis document. This is an example of Brisbane and it talks about the volume of petrol sold for various days of the week in the first half of 2006 versus the actual pump price. One can see that certainly, when the average pump price is low, volume is high—a relationship one would expect. Certainly those customers that buy at the lower price benefit. Our analysis estimates that the price cycles actually do benefit consumers.

CHAIR—We have heard some evidence from Mr Samuel from the Australian Competition and Consumer Commission, who told us that they estimate that approximately 60 per cent of motorists buy at below the average price in the weekly cycle—I think he was referring to capital city motorists. Would you agree with that?

Mr King—Yes. Our own internal analysis is very close to that number. We estimate 55 per cent of petrol is sold on low price days in our analysis of the three east coast capital cities. Within the accuracy of this information, we very much agree with the ACCC numbers.

Senator MURRAY—Just on the same point raised by the chair, have you ever been able to disaggregate the customers buying—in other words, those from fleets or who have corporate cars, who you would suspect would not be as sensitive to low prices, and those consumers who are just buying out of their own pocket?

Mr King—If we look at chart 30 in the original submission, that goes to the point about who the price sensitive buyers are. If you look at chart 30 here, we do surveys about what percentage of the population are price sensitive. As we can see, 60 per cent or more of consumers take price into account when buying petrol, so it is a large portion of the buying public. We do not have the breakdown of the demographics of the individuals that make up that 60 per cent.

Senator MURRAY—In my head I am wondering if it is, as you describe, 55-45. Otherwise, on average if you took, say, Mrs Jones, who is just taking it out of her pocket, it might be 80-20 sort of thing.

Mr King—Yes.

CHAIR—What does this go for? Is it 18 months?

Mr King—Yes, that is correct. It is a fairly consistent trend. Certainly in the first half of this year, when there were higher prices of crude oil and refiners were doing better, the price of fuel was more expensive and the numbers did tick up a few percentage points. The other point we would like to make in reference to (c) in the terms of reference is on chart 31, which is our analysis of discounters—this is chart 31 in the original submission as well as in the precis version.

CHAIR—What do you mean by discounters? What is the definition for the purposes of this chart?

Mr King—This is Caltex's analysis and this is looking at which entity in the price cycle is leading the prices down.

CHAIR—I see.

Mr King—As one can see from these pie charts, in the different areas we have Woolworths, Coles Express, Mobil, BP, Caltex and a number of independents.

CHAIR—I am sorry—I am going to press you for a bit more definitional clarity. When you say 'which entity is leading the prices down', I think we all have a general idea what you mean, but what is the test applied? Is it a factor of cents per litre by comparison to the next lowest price or expressed over a matter of hours? How is that calculation made?

Mr King—It is a base analysis of who is the first mover.

CHAIR—And that is indifferent to the margin of the discounting, is it? So, if there is any downward movement at all, that is the relevant datum?

Mr King—I will defer to Mr Ridley-Smith, whose group prepared that information.

Mr Ridley-Smith—We divide the country into market groups. There is in the order of 400 market groups and, in a market group, there might be between three and eight service stations. Our executives looked at each market group. From their own experience of looking at those market groups every day, they have a sense of who is being the first one to discount at any point in the cycle. For each market group, they recorded which particular service station, more often than not, drove down the price in that market group.

CHAIR—Does it follow from what you have said that, on this method, if for arguments sake, Caltex was the first mover and reduced the price of petrol by 2c per litre but shortly thereafter—within a matter of an hour or so thereafter—BP reduced the price by 8c per litre, it would nevertheless be Caltex, as the first mover rather than BP as the most significant price discounter within a short span of time, that would be treated as the more aggressive discounter?

Mr Ridley-Smith—In those market groups, what the executives are seeing is that mostly the non-aggressive player will match the aggressive player and then the aggressive player will go beneath them.

CHAIR—I imagine that is the way price-warring works. Nevertheless, what is the answer to my hypothetical question—if you care to treat it as a hypothetical case? These charts do not tell us about differential discounting margins; they merely tell us about the first mover, irrespective of the margin of the discount. Is that right?

Mr Ridley-Smith—That is correct.

CHAIR—Thank you.

Mr King—We do have a chart—chart 27—which gives an example of a typical movement which goes to Mr Ridley-Smith's point. You can see the typical response in both the precis version and the main submission. You can see that this is actually for the other part of the cycle, but the price is going up. It is the other side of the coin. They do not all increase at the same time and, as they come off, one can see the different peaks for different companies. There is such a transparency of information on petrol prices in this country—probably more so than any other country, both electronically to the oil companies and to the ACCC—that everybody knows what everybody is doing in a very short period of time, which enables people very quickly to follow once somebody leads.

CHAIR—I think you have been the victim of your own transparency, in a sense. Because it is so transparent, everybody sees them moving in parallel fashion and they assume that the market is being manipulated. That is the urban myth, is it not?

Mr King—Yes.

Senator MURRAY—That is a good point that was made by the chair. What you have described with your market groups is a very sophisticated form of market analysis, and to that you have added real-time reaction. In the old days of retailing, you might read the newspaper, cover the ads, drive around and you might get a few phone calls and you would get a feel for the market. That was a far slower reactive process. That is correct, is it not?

Mr King—That is correct.

Senator MURRAY—You really are into real-time marketing here.

Mr King—That is correct.

Senator MURRAY—That then leads on to my next question. It is one thing to be reactive but, of course, a retailer wants to be proactive and to lead the market. With such information available, do you think it is possible for someone to manipulate the market to suit their particular objectives? By the way, I am not implying that that is illegal—it is a perfectly reasonable thing to do. But it is possible with a highly reactive market, is it not, to press the right buttons and get the reaction you expect?

Mr King—It is very important to people who operate petrol stations to have high-volume traffic through their station. If somebody finds that the traffic through their station is low, they will follow the price down of somebody who has already led the price down to get their volume

back up. This is very much a low-margin, high-volume kind of business, and it is important that people bring more motorists into their stations.

From the standpoint of the person who operates the station—in many cases, franchisees—the majority of their profit actually comes from what they sell in their convenience store and not what they sell at the petrol pump. So bringing the traffic in is very important to maintain overall profitability. That is why lowering prices rapidly when somebody else does, to make sure that the traffic still continues to flow in to that particular station, is important not only for the petrol sales but also, more particularly, for the convenience store sales. Mr Ridley-Smith has put together some information about the relative weight of profit from convenience stores sales versus petrol sales, which could lead an individual who runs a station to lower their price quickly to make sure they do not suffer from a drop in convenience store sales if they have a drop-off in traffic.

Senator MURRAY—Do you think that a system such as Western Australia has, which tends to smooth the daily and the weekly market activity that you have describe for the rest of the country, is good or bad or does not make much difference? What is your reaction to that more managed market? I suppose I could describe it that way.

Mr King—Because the market is so transparent and information is readily available to people who run service stations and to the ACCC, the market moves much more quickly. We believe that consumers benefit from that because, if one station lowers its price, others follow very rapidly and customers do not have to shop around as much to get lower prices.

Senator MURRAY—Does that mean that you do not like the Western Australian system?

Mr Beattie—The point I think you are making is that you can only change the price in Western Australia every 24 hours.

Senator MURRAY—That is right.

Mr Beattie—It is unique in that respect and service station operators are unable to match the competition until 24 hours after. If, for instance, one has gone down and one has gone up and you find yourself in the wrong place in the market, particularly when you are high and the competition next door to you is low, we would argue—and I believe the ACCC has a similar view—that consumers are disadvantaged by the fact that the market is static for 24 hours all the time. One might wish to point to what has happened in Perth since Coles has come into the market, where the retail margins have been tighter and the prices have been somewhat lower. It has been an extraordinary situation where a new entrant into the market—in this case, Coles—has had incredibly intensive competition. We have got some charts that show that the difference between the TGP and the average retail price in Perth has been much narrower than in other cities because of the uniqueness of the change in the market with the supermarket penetration being what it has been over this period.

Senator O'BRIEN—That is one spin on it. Frankly, the statistical information that we have been given shows that the average price to consumers in Western Australia has been lower than in the eastern states' capital cities, ignoring the Brisbane tax differential, for the last 18 months plus. Are you saying that, without Coles, that would not have happened? Is that your suggestion?

Mr Beattie—I would like to defer to Michael on that one, because he has particular expertise in the area. It is a different situation to that experienced in the other major capital cities.

CHAIR—Senator O'Brien, I wonder if you would be kind enough to direct the witnesses and the senators to the evidence you have in mind?

Senator O'BRIEN—The evidence that we had from the Western Australian Department of Fair Trading, the evidence from the RAC and, of course, your chart 19, which shows the very small difference between terminal gate price and the average Perth pump price which in fact goes back to June 2003.

CHAIR—I indicate to the witnesses that, though you are not obliged to do this, if you feel it would be helpful—in order to more fully answer the questions that Senator O'Brien and Senator Murray have been putting to you—to examine the evidence that Senator O'Brien has identified, which appears in the committee's *Hansard* of its Perth hearings a few weeks ago, please feel free to do that and give us a supplementary written submission.

Senator MURRAY—My interest is in whether a managed market in the Western Australian sense is, in the long run, better for consumers and for the survival of independent retailers—because that is in my mind as well—than the much more open and reactive market situation in other states. There is no doubt that you people have a very sophisticated view of the markets, so your views would be of interest.

Mr Ridley-Smith—I might refer the committee to chart 58, which is a chart we brought with us in case a question came up about the straight average prices. Actually, I am not sure that the committee has this chart.

CHAIR—I do not have it. The charts in the submission go up to chart 48.

Mr King—We will provide this to you. We brought this along in anticipation of this question. We have it on the screen and we will provide it in hard copy afterwards.

Mr Ridley-Smith—You can see on this chart that Perth is the dark green line and there are odd occasions when it is lower than the other capital cities—other than Brisbane.

CHAIR—Is it more jagged, too? Is that the line you are referring to?

Mr Ridley-Smith—Yes. In the main, this data shows that it does not have a substantially different profile than the other capital cities.

CHAIR—So the very noticeable difference with the Brisbane price, reflected in the mustard-coloured line, is the Queensland government subsidy, is it?

Mr Ridley-Smith—That is correct.

CHAIR—I would like to go back to the price cycle chart—the previous one that you showed us. It strikes me that one of the ironies of this inquiry—and I asked the economists about this—is that a perfectly competitive, highly elastic, very transparent market for a uniform commodity

like motor spirit would look like that among a group of competitors, but a collusive fixed market would look the same, would it not?

Mr Ridley-Smith—Would it come down?

CHAIR—That is a good point, Mr Ridley-Smith. Although it would look the same, if one of those lines actually stayed high, I am inclined to think that that would be more inclined to get you worried than if they tend to move down. As Senator Murray knows—probably better than anyone else here—the basic test of market power is a capacity to change prices without reference to competition. So we have a section 46 and not a section 45 issue.

Senator MURRAY—That is right.

CHAIR—Sorry, go on with your presentation, Mr King.

Mr King—They are very good points and we had hoped to be able to get into this kind of discussion. If we go back to chart 31: on our analysis, which is based on who is first mover in leading prices down, it is the supermarkets who are the most aggressive discounters in every single area—in New South Wales, Queensland, Victoria, Tasmania, Western Australia and, to some extent, in South Australia.

CHAIR—I would like to ask a really simple question. Again, people are fixated by this price cycle—and it is very interesting. Going back to the price cycle chart, why is it a weekly price cycle and not a monthly or a fortnightly price cycle? Is it as simple as the fact that the average fills up the car once a week?

Mr King—That is a very interesting question, actually. I have been in the country for only six months. Certainly the cycles here are far more rapid than I have seen in other countries. There have been a number of explanations offered as to why the market has moved to such a mode of operation. One is that the information on what the market is doing is more transparent and more readily available to all competitors. It is a very sophisticated electronic system here.

CHAIR—Would that tell you anything about the frequency of the cycle?

Mr King—It would not but it enables people to follow more quickly and keep the cycle going. The best explanation I have heard is that the cycle is a legacy of how the market used to operate in a more regulated mode up until 1998—and I think Mr Beattie has his assertions of why the cycles are the way they are now because of that history.

CHAIR—I think we would be very interested to hear that, Mr Beattie.

Mr Beattie—Until August 1998, the ACCC used to fix what was called the maximum endorsed wholesale price. Each day Caltex would have to send an advice down to Melbourne that was calculated on the MOPS 95, as being the reference price in Singapore, and then allowances were made for freight wharfage and insurance. Then the ACCC, after an inquiry that I believe was done by its predecessor, the—

CHAIR—The Trade Practices Commission.

Mr Beattie—Yes, the Trade Practices Commission. The ACCC set 7.1c a litre. In that period during the 1980s and the early part of the 1990s, 7.1c a litre might have been an appropriate amount of money that was needed for a wholesale margin but, as the industry became more competitive—and while, at the same time, Australia had surplus production capacity in the refineries so the market was long—we had a situation where the independents saw the opportunity of being able to buy cheap and, as refiners were quitting, the stocks that they needed to clear, because the next petrol was coming through the system, was discounted at the terminal gate.

A system developed where there were smart independents who recognised the arbitrage opportunity that was there in the market. They would go in and buy at the bottom of the cycle and go back and sell the product through their service stations. They knew that when they got down to that really low point where they may have actually been selling at a loss, they would always be able to go up by 7.1c a litre, because that was where the ACCC was going to endorse what the wholesale maximum margin was going to be.

CHAIR—And that is how the independents won market share in the late eighties and early nineties, was it not?

Mr Beattie—Exactly. So, once the system started developing like that, needless to say, the other competitors started to say, ‘We have to be much smarter about getting information.’ So Informed Sources saw its market opportunity to provide the information. They started off by having people in vehicles going around looking at the price and phoning in what it was. Now of course we have the situation where, every time a swipe is made, that electronic information on the sale and the price is made available to Informed Sources. They collect the information and distribute it.

As Senator Murray was saying, there is virtually an instantaneous real market—which is very close to the stock market—availability of information that allows Michael and his teams to respond quickly. The chart as we saw a moment ago allows a very quick matching. Service station operators depend on 50 to 75 per cent of their gross revenue coming out of the store. They have to make sure that people are coming in and buying the fuel, so that they will also buy in the convenience store and keep your business viable.

Senator MURRAY—This is the first time I have ever understood that it is actually a broken—

CHAIR—It is an epiphanic moment.

Senator MURRAY—It is absolutely fascinating.

CHAIR—Mr Beattie, there is a lot of interest in the role of the independents—the canary and the coal mine, as it were, of the market. Is it right to say that, whereas the independents were able to do well in the late eighties and early nineties because they could buy at spot prices as there was surplus refinery and terminal capacity, the elimination of that, or the reduction to zero of that surplus capacity, has meant that there are not the spot deals available for the independents these days that there used to be?

Mr Beattie—Certainly not. The market has moved from an export parity priced basis. You may remember, if you go back to the Caltex-Ampol merger in 1995, that one of the conditions that the ACCC put on the merger was that independents would be supplied and then of course the Liberty network developed out of the deal that was done at that time. It was all based on the fact that there was a surplus and the ACCC was keen that independents would have the opportunity to operate in the market, given the new company that had been formed. Subsequently, we have seen three significant developments: market growth overall, as demand for petroleum products has increased; the closure of the Port Stanvac refinery; and, the change in Australian fuel standards. We had no standards. You could put toluene in petrol and call it petrol and it would still be legal. That circumstance has now changed and we have world-class quality standards.

Those three changes have led to circumstances where the whole market has moved from export parity as the basic pricing to import parity and the removal of the sorts of opportunities that there were that I mentioned that led to the beginning of the Australian cycle process. As Des mentioned, we are not aware of anywhere else in the world where the market has developed like this, and we would attribute it to the history of regulation. That is one of the reasons that Caltex remains so firm on recommending that we should maintain an unregulated market.

CHAIR—And those independents that do well these days are the bigger independents that can get bulk volume discount supply contracts, rather than pick up fuels on the spot market? Is that right?

Mr Beattie—Yes, and with significant operators: Gull in Western Australia; Matilda, significantly; Liberty has had a very significant role and is still an important player.

CHAIR—That is very interesting. Are there any questions for Mr Beattie arising from those last observations before we go back to the presentation?

Senator STEPHENS—With respect to slide 31, does Caltex provide price support to enable your sites to be competitive where this kind of aggressive discounting is occurring?

Mr King—As part of our franchise agreement we will provide price support if there is a request for it. It is part of our agreement with our franchisees to support them and certainly at the bottom of the cycle if the cycle goes so low that they are not making money. Mr Ridley-Smith can comment in more detail about how we provide that support.

Mr Ridley-Smith—Every day, as we are watching these prices move, we are making a determination on what support we should provide an operator to meet the competition in their particular market group. So there is price support for individual service stations by market groups around the country. As I mentioned, there are 400 to 450 market groups—a significant number. They are provided, in effect, a rebate on their purchase price—because obviously they will have purchased the product that they are then selling—and we will give them a rebate based on the volume that they sell at that supported price.

Senator MURRAY—Just one last question on this. Is this system of market reactivity, which is facilitated electronically, a 24/7 system? Obviously the capture of electronic data would be, but what about the human reaction to it? You have said that your executive watch these things.

Do you have teams of people operating over weekends as well or is the weekend a different market situation from the week because people go home?

Mr Ridley-Smith—We have people watching the market every day of the year, including Christmas Day, but we do let them go to sleep. We do not have people working 24/7. We have a contract with Informed Sources to provide data, and we can nominate exactly what data we want to receive. My recollection is we get a feed at 11 o'clock in the evening and the next feed is at five o'clock in the morning. And there is generally not too much of a price change between—

Senator MURRAY—And that takes into account time differences between the various states and so on as well, I suppose?

Mr Ridley-Smith—Yes.

Senator O'BRIEN—Would I be right in assuming from all of this that not only do we have a retail market where, through the fluctuations, there is an intention to achieve a positive profitable outcome on trading but your role in providing price support is about volume business and achieving an overall margin within that volume through the fluctuations of the market?

Mr Ridley-Smith—Naturally, we are looking at our overall margin. Equally, we are looking at our overall volume. We have a very complex system. We are selling a billion litres of diesel and petrol a month. We have to forecast three months out and we make an estimate of what we will be selling in a particular month. As the product flows through the system, we are having weekly discussions with our supply colleagues. We have to make a determination on how our supply chain is sitting with inventory, and we have to make sure the product flows through the system. So we are looking at that and we are looking at the overall margin of the business.

Senator O'BRIEN—You are feeding into the production volume core and trying to manage the sale of the production so that you are not ending up at the end month with more in storage than is manageable as production comes through the system.

Mr Ridley-Smith—Absolutely. It is absolutely critical at this time that we do that with accuracy. We are importing product on a regular basis, so we have to make calls one month to two months out on what cargos we will order to meet a particular month's demand. Every day, as you saw on that price cycle chart, we are looking at where the price is in a particular city in a particular market group, determining what the volume is that we are placing out of the relevant terminal and making an independent decision on whether we need to increase volume or whether we need to discount for a whole variety of reasons.

Senator O'BRIEN—At times when the market price is low, do you scale back volume? You are not making as much money on the volume, so you are losing money?

Mr Ridley-Smith—No. The only way that you would affect volume in that circumstance is to make a decision that you could afford to price your product higher and you would have less foot traffic.

CHAIR—We will go back to your presentation, Mr King.

Mr King—The last point we wanted to make on price cycles is long weekends, which is always a question that is raised when there are long weekends. If we refer to chart 32 in both the precis document and the original one, it shows the trend in Brisbane around the Easter long weekend and the Queen's birthday weekend. The black line is the TGP for Caltex and the average pump price is the purple line. As you can see from this information, the prices do not jump because the long weekend followed basically the same cycle as other weeks and other weekends.

In fact, we have a separate chart—chart 55—which we will supply to you after the session. We looked at the most recent long weekend—a Labour Day weekend—and we picked Sydney this time. It is a similar kind of chart. The black line is the Caltex TGP and the red line is the average pump price in Sydney and the bottom chart does the same thing for Adelaide. One can see in general the cycles that cycled through the long weekend are in the same format as the cycles through the previous and the post—

CHAIR—While we have got chart 32 before us; in the bottom part of the chart we see a breakdown of the weekly cycle for a period in May. What would explain that?

Mr Ridley-Smith—I will attempt an explanation. Every week that there is a petrol retailer increasing their price, all of the other retailers have to make a decision as to whether or not they will also increase their price. Generally, most weeks the market moves to follow one of the players who has increased their price. On occasion, someone will increase their price and none of the other retailers—perhaps a small number of sites will—will move up to match that sort of level. The company that has raised their price will very quickly see their foot traffic drop off, their volumes drop off and, if they are sitting out of the market by, in some cases, 10 to 12c they will then have to make a decision as to whether or not they again go back into price support to match the discounted market price.

CHAIR—How could it be that the companies which were not the first movers all decided not to follow the price without collusion?

Mr Ridley-Smith—This is averaged over a day, and the chart that we were looking at was, I think, chart 27, is looked at every three hours. The oil company executives are looking at that every 15 minutes, every 30 minutes, every hour and so when you look at the chart on a three-hourly basis you might not see a rapid spike—

CHAIR—That is not really an answer to my question, though. I am readily persuadable that the price following reflects an elastic and transparently competitive market. I can readily understand how if one company decides to stay out of a particular cycle it might do that in pursuance of a commercial strategy. What I find difficult to understand is how, in what had anteriorly been a price-following environment, a decision by one company not to price follow on a particular day would itself be followed by the other companies which had been in the price following cycle. Do you see what I mean?

Mr Ridley-Smith—Sure. I might refer the committee to chart 35. This is a little bit more detailed. You will see on 10 May that one of the players has led a price up to what looks like 142.9c. Some of the other players have moved some of their sites. You can see the yellow line has moved up a few cents. It is very difficult to see but the red line has also moved up

underneath that blue line, and then you can see that the blue line has come down a little bit more slowly because it is only a daily data—

CHAIR—You say the ‘blue line’; it is blue in the hard copy, but what you are talking about is what, on that transparency, I might call the dark purple line. Are we talking about the same thing?

Mr Ridley-Smith—Yes, the peak on 10 May. So what you see is a number of different players who have moved up to varying degrees to match that peak and then very rapidly declined as they have seen that the bright purple line on that chart has stayed down at the lower level.

Senator MURRAY—On the ‘long weekend’ chart, I was fascinated by the study of the effects of psychology, which began in the thirties with respect to the economic theory and behavioural consequences. Do long weekends have a different psychological impact on consumers? Are they more sensitive and more alert to prices because it is a recreational time when mum, dad and the kids are in the car together far more than they would be in a normal trading week? For instance, in my state of Western Australia, typically, several hundred kilometres is the normal trip over a long weekend either down south or up to Geraldton which would be six hours—that sort of thing. Therefore, I think they might be more alert to and more conscious of fuel prices. They might have switched over the company car to the family car and it might be a topic of discussion. We as politicians are alert to the chatter which lifts more about petrol pricing over long weekends and my question to you, with your very sophisticated market analysis techniques, is: is there a phenomena that people are more alert to and reactive to those prices at that time?

Mr Beattie—I would put it down to the media in many respects. The media have a whole series of stories that are repeated time and time again, and petrol prices and holiday weekends are one of those stories which you can be sure will occur regularly. We have experienced this. We get ready for it, and we put information out—such as the sorts of things that we are discussing with you today—but, frankly, the industry is a whipping boy when it comes to this sort of thing.

CHAIR—It is good to see somebody else blaming the media.

Senator MURRAY—We will come and sit with you.

Mr Beattie—So I suggest that it is this constant opportunity the week before a holiday weekend for various people—and not just the media. There are certain motoring organisations whose representatives say, ‘Look what’s coming,’ but they could as just as easily make the comments that we have been making about price cycles. We are more than prepared to say to consumers, ‘Take advantage of the cycle.’ The reality is of course that, if 55 per cent to 60 per cent of consumers are buying at less than the average, they are smart and are taking advantage of it, and that is not a point that is made very often.

CHAIR—I think that is a very powerful point, but I think it leads to an even more powerful point, and that is that if the market were being manipulated or fixed then those who are doing the fixing would make arrangements to ensure that most people were not buying at the bottom of the cycle.

Mr Beattie—That is right.

CHAIR—Senator O'Brien has to go about 10.30, and I want to give him, as the opposition spokesman, the opportunity to ask a series of questions of his choosing rather than to just follow the discursive but very useful discussion we have been having.

Mr King—Let me conclude by saying that Caltex supports the continuation of an unregulated petroleum products market in the belief that the current arrangements provide the best environment to encourage the large, ongoing requirements for capital investment in the industry and the maintenance of a secure supply of transport fuel for Australia.

CHAIR—Thank you very much.

Senator O'BRIEN—In your charts 15 through to 21 you have a dotted line which is the terminal gate price in the various markets. Is it fair to say that that is the highest wholesale price in the market, not the lowest?

Mr Ridley-Smith—I can answer that question. The terminal gate price is the price that we post publicly for a customer who is not under contract to arrive at a terminal with a safe tanker, pay cash on delivery and take a load of product away. Clearly, there are some customers that we have under contract who have a wholesale price which is less than the TGP because they buy a particular volume and are prepared to contract with us for a period of time. We have other customers who obtain from us a variety of other services, and therefore they pay more than the TGP. So it is a benchmark.

Senator O'BRIEN—So that price includes other services, which might include delivery, terms of trading, site maintenance, pump maintenance and the supply of pumps?

Mr Ridley-Smith—That is correct. That is why they might pay a higher than TGP price.

Senator O'BRIEN—Because of those matters being rolled into the contract and expressing the value in cents per litre, I would imagine?

Mr Ridley-Smith—To some extent, yes.

Senator O'BRIEN—Then the concept of price support is, for want of a better term, another way of discounting the terminal gate price?

Mr Ridley-Smith—The franchisees in the Caltex network buy off a reference price which is different from the TGP. I might just take the committee to chart 54.

Mr King—We had better just try to explain the variety of wholesale prices. We did a variety of wholesale prices and we will provide a hard copy of this later.

Mr Ridley-Smith—So we have two what I guess you would describe as wholesale reference prices—they are prices to resellers. The first line is the Caltex reference price, described as CRP. This is a price that we prepare every day for the franchisees in the Caltex network and is the one uniform national price that complies with section 20 of the PRMF Act—the Petroleum Retail

Marketing Franchise Act—which requires that you provide all franchisees with the same price. That price is made up of the product marker—generally Singapore Mogas 95—plus the Australian quality premiums, plus the freight insurance, wharfage and a marketing margin. You will see that between that and the next two prices the main difference is in the type of margin that we apply. The next line down is the TGP, which is uncontracted resellers. So it might be a single service station operator or it might be an independent distributor who came to collect—but someone who has no long-term contract and an entity which we have not decided to give any discount to. So it is a benchmark for that uncontracted reseller. Below that you have a formula price, which is for the large independent customers.

So the marketing margin for the Caltex reference price is higher than the terminal gate margin because it does include issues like the provision of brand. We do advertise our brand on TV. We provide credit terms and business manager support—so we have business managers who go and give these franchisees advice on how best to run their shops and forecourts. We also provide them with access to the StarCard charge card system, which is obviously attractive to them; that brings in another proportion of sales. So they are getting an all-up inclusive price, and when we provide price support they are getting a rebate on the Caltex reference price.

Senator O'BRIEN—I think you said the Caltex reference price was a nationally set price but some of those additions vary between markets. Is the marketing margin something that varies between particular markets?

Mr Ridley-Smith—The marketing margin that we include in our calculation of the Caltex reference price is the same nationally. The terminal gate prices do vary by terminal. By their nature they are the price at a particular terminal.

CHAIR—Why would they vary between terminals?

Mr Ridley-Smith—Every terminal has a different set of economics. For example, the shipping from Singapore is cheaper to Western Australia than to Sydney.

Senator MURRAY—Just to clarify, regarding the Kalgoorlie price, which is inland, and the Perth price, according to what you have just said you would supply the same product at the same price. Is that right? Surely you have got to take into account the transport difference.

Mr Ridley-Smith—The Caltex reference price does not include freight. The franchisees do pay freight on top of the Caltex reference price.

Senator MURRAY—So you will have a country-city variance?

Mr Ridley-Smith—Yes, but it will be only related to the actual freight cost.

Senator O'BRIEN—Are you able to give us on notice some idea of the freight costs between metropolitan and non-metropolitan areas by market—for example, in so many cents or fraction of a cent per litre delivered?

Mr Ridley-Smith—It does vary between 0.5c and 3c a litre. There may be some extreme remote locations where it would be higher.

Senator O'BRIEN—So we can look at, in most cases, 3c being top of the range?

Mr Ridley-Smith—In the main, if you were looking at an average for a state. Generally the very remote locations will not be franchised operations; they will be operations conducted by an independently owned reseller who buys at our terminal and they make their own transport arrangements. Where we are making the transport arrangements for franchisees, they are generally in the range of 0.5c to 3c.

Senator O'BRIEN—In terms of refiner margin, we had some evidence that indicated that for Caltex for the first half of this year, even though you had a period when the refiner margin was negative, on average your refiner margin for the first half of this year was higher than the previous two years and that at one stage it went to 18c per litre. We were told that that information came from material which Caltex had reported. I am sure you are aware of that evidence. What do you say about it?

Mr King—That was in our first-half results. I believe \$US10.62 per barrel was our refiner margin for the first half of this year, and that really reflects the refiner margin in Singapore, plus the freight, plus the quality premium. What we are seeing in the world is that certainly there is a very tight refining market. What has happened is the demand for petroleum products worldwide has increased significantly, particularly driven by India and China, and there has not been the refining capacity to actually keep up with that demand. That has actually made the improvement in refiner margins. Going back a few years, in the late 1990s there was an excess of refining capacity compared to demand, and margins were very low. For example, the average Caltex refiner margin for 2001 was \$1.61. At that kind of level, Caltex was basically finding it hard to survive—overall, the company was not viable—but the pickup in demand has certainly helped the refining business worldwide.

Senator O'BRIEN—And your share price.

Mr King—And it certainly helped our share price. That was when our share price was \$1 and now it is in the 20s, which reflects the confidence of investors that we have a good business for the long term. There are a number of refinery projects being announced in Asia. India, for example, is planning some major expansions. Will the refining capacity stay as tight for the next several years? It is very difficult to tell. Certainly, from our analysis, these refining capacity additions are required because demand growth still remains fairly strong.

Currently, the world consumes about 84 million barrels of oil a day. Various estimates are that there will be growth, although it depends at which level—but certainly by the end of this decade it is anticipated that the demand for oil could well be at 90 million to 95 million barrels a day. A number of people have said about 92 million barrels, so that is a six million barrel a day increase in oil consumption. Hence we need of the order of six million barrels a day of increased refinery capacity to be able to process that oil.

Senator O'BRIEN—Just to stay in a very tight capacity circumstance?

Mr King—That is right.

Senator O'BRIEN—What is the expected circumstance at the end of this decade? We will still be in a very tight refinery capacity situation, I take it.

Mr King—If China and India keep growing at reasonable rates—and they are the drivers, through the increased consumption—then it is anticipated that the refining capacity will remain tight. Whether it will be as tight as the first half of this year only time will tell. There are a number of new refining projects coming on, and whether they come on ahead or behind the demand curve will impact where the refiner margins go, but one is certainly anticipating that refiner margins will be robust for the next several years. Whether they will be as high as the first half of this year only time will tell.

Senator O'BRIEN—So the likelihood is that, although there will be fluctuations, we will see relatively high petrol and diesel prices for consumers for that period.

Mr King—In our analysis, for example, for the first half of this year about 90 per cent of the increase in price was due to raw material—which is crude oil—price increases and then about 10 per cent was due to the tight refining capacity with higher refiner margins. Where prices go long-term is largely dictated by where the price of crude oil goes long-term and then to some extent the tightness of refining capacity. One can anticipate that, unless oil goes back to the historic \$20 to \$25 a barrel, certainly we will not be able to enjoy the kind of petrol prices we did a few years ago. And nobody is predicting that oil will go back down as low as the 20s. It was only five years ago, actually. It is amazing how rapidly the world has changed because of the rapid growth in Asia.

Senator O'BRIEN—Given the prediction of somewhere between six million and 11 million barrels per day growth in demand for oil for refining, it is hard to imagine circumstances where the price would not go up, isn't it?

Mr King—It is, and it is a function of how much new oil production capacity can be brought on. First, the dominating factor is what happens to crude oil prices, followed by the secondary factor of what happens to refining capacity. Although as we said in the last few weeks there has been a very rapid drop-off in the price of crude oil—although it is still about \$60 dollars for West Texas Intermediate, so in historical terms that is high—there has also been a very big drop-off in refiner margins. It shows how fluid the market is. There was a large build-up of petrol inventories in the United States in anticipation that there could be another hurricane. The hurricane did not come and those petrol inventories are now being worked off. That is depressing petrol prices around the world to the point where, as we saw in Singapore, petrol prices are now below crude prices. My guess is that that will recover by the end of the year as the inventory in the United States is worked off. Certainly the second-half refiner margins are unlikely to be as robust as those of the first half of 2006.

Senator O'BRIEN—What impact do climatic factors in the Northern Hemisphere have on that? We are talking about the first half of the year—that is, the second half of the financial year—in terms of Caltex's historic refiner margin position, but how does that sit with second half of the year and the northern winter? What impact will that have?

Mr King—There is very much a cycle that is seasonal as a function of the Northern Hemisphere. In the absence of unusual events like hurricanes, which had a major impact just

over a year ago in the United States, the typical cycle is that refiner margins are stronger in the Northern Hemisphere driving season, which is typically their summer. They drop off again at the end of the third quarter and into the fourth quarter, then the margins pick up again because of the home heating oil season in the winter in the Northern Hemisphere; then they drop off again in the early part of the year as winter ends and pick up again in the driving season. The high margin times typically are the Northern Hemisphere summer and the Northern Hemisphere winter, and then in the period between those two times the margins tend to be weak or even negative.

CHAIR—Approximately what percentage of the fuel consumed in the world in a calendar year is consumed in the Northern Hemisphere?

Mr King—I do not have the exact number for that. The United States is certainly the dominant player. Of the roughly 84 million barrels of oil that are consumed, I think about 25 million barrels are consumed in the United States alone. So the United States is a very major player in the overall consumption, and in fact it is really not just the Northern Hemisphere driving season but the American driving season that really cause those fluctuations in the refiner margins because of the increase in demand, or drop-off in demand, for products, depending on the time of year.

CHAIR—You would expect, wouldn't you, considering the concentration of the population of the industrialized world in the Northern Hemisphere, that it would be of the order of 70 or 80 per cent?

Mr King—That seems like a very reasonable number.

Senator O'BRIEN—Thank you for that. The only other area of questioning I have is about the price cycle information that you provided for us. We talked about a seven-day price cycle. Can you give us your view as to why in the Perth market it is more like a 13-day price cycle?

Mr Ridley-Smith—At this stage it seems to have settled around 14 days. As with any competitive behaviour, people are looking to see what their competitors will do to a particular reaction. You are always hypothesising on what your competitors will do when you move. Generally the market is building in some normality so that people see a particular reaction and they react in a similar, consistent fashion.

CHAIR—And in anticipation too, presumably.

Mr Ridley-Smith—Yes. I would expect the first movers would be expecting the other players to follow them, but that does not always follow.

Senator O'BRIEN—You might not like it, but I have used for this price fluctuation situation in the petrol market the term 'price gaming'. Someone will say: 'I want to boost my margin so I'm going to test whether someone will follow me. I'll throw my price up a bit and see if people follow.' In everywhere but Perth you can go up and then down in the same day in a matter of hours or even minutes. It is less risky to throw your price up because you can get down more quickly. But in the Perth market you throw your price up and you are there for 24 hours. The West Australian agency responsible for FuelWatch says their system operates in a way which

discourages the bigger rises because you are stuck with them for 24 hours. Do you disagree with that proposition?

Mr Ridley-Smith—I am not sure whether what we are seeing occur would agree with that statement. We are seeing relatively large swings every two weeks. We are also seeing that some of the players—some of the oil companies and some of the supermarket chains—will move some, but not all, of their sites so that they are not, because of this 24-hour rule, hung out to dry for 24 hours and they do not have to throw away all the milk on the shelves because there is no foot traffic throughout their whole network. They will test how the market will react by moving a certain number of their sites.

Mr King—The other question is: if people are reluctant to go as high because of the time delay are they also reluctant to go as low because of the time delay? As we saw from the slide earlier, the average price in Perth seems to be pretty much in line with the average price in the other major cities.

Senator O'BRIEN—The evidence we have is that statistically it is lower, the bottom of the cycle is about as low as anywhere else and at the top of the cycle—

CHAIR—The evidence is obviously not uniform. There is some evidence to that effect, but I think Mr King makes a fair point that the evidence that he has presented does not support that proposition.

Senator O'BRIEN—With respect, from the RAC evidence, the bottom of the cycle in Perth certainly seems to go as low as the bottom of the cycle anywhere—except Brisbane, of course, because of the special factor there—but the top of the cycle, from the graphic information we have, does not seem to peak as high. You are challenging that. I would be interested to see if your material—the figures that you are working off—is different to that of the RAC, for example.

Mr King—We did show the average price. The focus always is on the top and the bottom but the average is what is important. The chart we showed a few moments ago indicated that the average price in Perth is very much in line with the average price in other major cities, apart from Brisbane because of the tax differences.

CHAIR—Can I reiterate, perhaps with a little more emphasis, something I said earlier. The issue of the Western Australian system is obviously of great interest to all of us but of particular interest to Senator O'Brien and Senator Murray, I apprehend. I do not want to cut you off, Senator O'Brien, but, rather than have a discussion in a vague sense about something which is really an empirical and statistical matter, could I ask Caltex to look at the Western Australian evidence carefully and give us a supplementary submission?

Mr King—We would be very happy to do that.

CHAIR—That will deal with all the issues that have been raised.

Senator O'BRIEN—I am happy if you want to supplement your submission—and, indeed, the submissions that we have received that are on the record—in relation to the Western

Australian system. I did not bring the submission with me, but essentially the evidence we had from the department of fair trading, I think it was, was that, on average, the price in Perth over the last 18 months has been lower than every other capital city, excluding Brisbane, for those special reasons.

CHAIR—It is not unknown for a regulator to defend their own regulatory systems.

Senator O'BRIEN—That is true, but I am sure that those who have a different view would suggest that, if you thought that, why didn't you put propositions to witnesses who might have a different view, and that is what I am doing.

CHAIR—Sure. I am not criticising. Are you finished?

Senator O'BRIEN—Yes, I am finished.

CHAIR—I have a couple of questions. Can I ask you to go to chart 27 and to chart 35. One of them is a week in July of this year in Sydney, and one of them is in May of this year in Melbourne. For the purposes of the exercise, looking at chart 35, the Melbourne chart, let us try and define a particular week. Let us take the week 10-17 May—the week that starts with that big spike by Mobil, that does not appear to have been followed by the others, and then comes down sharply about a day later. I appreciate these are just snapshots in time. We do not see in chart 27, the Sydney chart, the non-synchronous behaviour that we see—in that particular week, at least—in the Melbourne chart. Some people might think that the Melbourne chart shows a more aggressively competitive market, because there is not an almost automaticity about the price-following behaviour. What do you say about that? Why are the two markets different—or is that just the way it happened to be in those particular random weeks?

Mr Ridley-Smith—Within a particular month, each of the players has to make a decision about how their volumes are tracking and how their shop sales are tracking. We cannot speak for what Coles in particular was thinking on 10 May, but you can see by the chart that, on 10 May, they elected not to price at the top of the cycle; they wanted to continue to generate sales in excess of their average share of sales.

CHAIR—You might remember a remark I made earlier this morning, Mr Ridley-Smith. The Sydney market chart, chart 27, which shows very close parallel conduct, is perfectly consistent, I think, with a highly competitive, highly transparent, very elastic market. But it is also perfectly competitive with a collusive market. You would get the same data from each. Whereas the Melbourne chart, chart 35, is certainly not consistent with a collusive market. Nor is it consistent with a market in which there is market power being exercised by Mobil; because the others did not follow Mobil up, Mobil is dragged down to the pack very smartly. Whereas the Sydney chart, chart 27, is consistent with both a benign and a non-benign interpretation of price fluctuations. The Melbourne market, as graphed in this chart, is, it seems to me—and I am not an economist but I was a competition lawyer once—consistent only with a highly competitive market in which there is no market power being exercised. What do you say about that?

Mr Ridley-Smith—I believe both charts show that the players in the industry are making independent decisions. They are making them hourly, they are making them daily. In the Sydney chart, there is not an hour-by-hour correlation. You do see delays in people deciding whether or

not they will follow someone else's price. You see someone going a little bit higher than the other players and then people discounting below that, and you see someone deciding not to go right to the same peak of the cycle as other players. They are all independent decisions based on how each player in that particular market wants to earn shop return and pass volume through its sites.

Mr King—One thing we should comment on is that these are different time periods, and it appears—

CHAIR—I allowed for that. I said that it might just be the randomness of the particular snapshot in time that has been chosen.

Mr King—It actually appears, from some other information that we have, that in this time period in May—across many cities, not just Melbourne—both Coles and, I assume, Woolworths, were entering into a period of major discounting below the TGP. In fact, if we look at chart 32, Brisbane—which we talked about earlier—we can see that same May time period and it went into that same region where the supermarkets were really discounting below TGP aggressively.

CHAIR—You are talking now about the flattening of the cycle in the bottom portion of the chart, which, as you rightly point out, reflects a similar period to the Melbourne pricing chart, chart 35.

Mr King—That is correct.

CHAIR—To sum it up, it seems to me that, perhaps for historical reasons, there has become such a degree of automaticity, at least in the capital city pricing, about the price cycle. Whether through following or anticipation or a convergence of both, this just happens and, if it were to be stopped, the players would have to put their heads together to stop it, and that would be collusion. Do you agree with that?

Mr King—Yes we agree. You are absolutely correct.

CHAIR—As a matter of law you could not possibly do that without being in breach of section 45 of the Trade Practices Act, could you?

Mr King—That is right.

Mr Beattie—Mr Chairman, seeing we have spent quite a lot of time on this—I am just thinking of somebody reading the *Hansard* and the questions that have been asked about this—I wonder if I might read the last paragraph on page 17 of what we have given you, because it does give an explanation.

CHAIR—You want to read it onto the record? Yes, you can do that.

Mr Beattie—Talking about chart 35, the Melbourne pump prices in May 2006, we said:

This period of intense discounting could be due to a number of factors. Most notably April saw a steep decline in the volume of petrol sold nationally compared with March (10% drop) due to the sharp increase in price (Caltex TGP

increased by 7%)—see Chart 5. Both Woolworths and Coles rely on petrol sales to drive supermarket sales through their shopper-docket redemption offers. By reducing their profits from petrol, or eliminating for a short time, they can increase their supermarket sales volumes and also their relative petrol market shares. It is therefore possible that both supermarket chains drove petrol prices down in May to recover from poorer sales in April, with inter-company rivalry adding to competitive pressure to lift sales.

CHAIR—Thank you. Are there any questions arising out of that?

Senator O'BRIEN—No, I had already underlined that.

Senator MURRAY—I would just add one observation. I accept the evidence that they gave us; the supermarket chains nevertheless have indicated that they run their service station business as a separate profit centre and seek to make profit. In other words, it is not a constant loss leader for the supermarkets. I think that is an important point to make. Whilst at times they may manipulate it for their total business reasons, overall they argue that it is a profit centre. I presume you do not dispute that, because a reading of that material might imply that this was entirely a loss leader business.

Mr King—We have no evidence that suggests they run that business as a loss leader.

CHAIR—Senator Stephens has one small area on which she wishes to ask some questions, and then I think that will be it.

Senator STEPHENS—Gentlemen, on page 21 of the submission, you make some comments about biofuels. The committee has had some evidence about the costs involved in preparing sites for the sale of biofuels. Could you enlighten us as to those costs, the kinds of preparations that it would involve and whether or not you have done some work on how you might prepare sites?

Mr Ridley-Smith—As of today we are selling E10—a blend of 90 per cent ULP and 10 per cent ethanol—at 63 sites around Australia, including a site in Canberra, at Tuggeranong. The costs involved in converting sites to be able to sell E10 vary enormously. They depend on your decision as to whether you will only sell E10 as your base, regular unleaded petrol at that site—and we have a few locations like that—or whether you are planning to sell it as an additional product at that site, which means it has to have its own tank and its own pump. We already have a suite of three regular unleaded petrols—91 octane, 95 octane and 98 octane—so, if we add E10, we have to have service stations that can sell four.

Where we have used existing tanks, we have needed to do work on them to convert them over. When you put ethanol in a tank, you need to let it settle. Ethanol has a scouring effect—it will de-scale a tank—and the sediment drops to the bottom of the tank. You have to recycle the E10 product to ensure that the tank is clear of all sediment before allowing the product to be sold through the pumps. There is a contractor process for that. It costs some thousands of dollars to have contractors turn up at the site and cycle through perhaps 40,000 litres of product to make sure that the tank is clean.

At other sites we have had to do line work where two tanks have carried all of the ULP and we have decided that one tank will carry the ULP and the other tank will carry the E10. Changing the line work at those sites—ripping up the concrete and making those changes—might cost

between \$20,000 and \$40,000. Then there have been instances where we have decided to add a completely new tank and pump system, and that can cost anything up to, or perhaps more than, \$100,000. It can involve a huge range of factors, depending on the work that you do.

We have to look very carefully at the demographics of each area to decide what we want to do, because our research shows that at least one in two consumers is not willing to trial ethanol. Our research still shows that there is enormous consumer reservation about ethanol. We are happy to sell the product and we are happy to promote it, but we believe that it has to be a choice for the consumer. Our intention is to provide that choice rather than force it on consumers.

Senator STEPHENS—You say that you have 63 sites.

Mr Ridley-Smith—Yes

Senator STEPHENS—Is it your intention to expand that number?

Mr Ridley-Smith—Yes. It is being worked on at the moment. We will have 110—possibly going as high as 140—sites by the end of the year.

Senator STEPHENS—Is there any kind of price support for the 63 sites at the moment?

Mr Ridley-Smith—We price the wholesale price of the E10 product at 3c below regular ULP at the locations where we currently sell E10. If that site is one which is provided price support for its petrol sales, the price support will be placed on all the petrol products sold at that site.

Senator STEPHENS—Where are you sourcing the ethanol from?

Mr Ridley-Smith—We have contracts for supply from Manildra at Nowra, and we have a contract for supply in place with CSR out of their Sarina plant in Queensland.

Senator STEPHENS—We have heard evidence that, with the growth in the market, there is not enough capacity to supply. Is that your experience?

Mr Ridley-Smith—There are two major suppliers of ethanol—and that is it, at this stage. There is one very small supplier in Brisbane, but their volume is under contract. I think it is only several million litres that they can supply. So we have contracts with the two major suppliers. The volumes relative to the scale of petrol sold in Australia are slight. Caltex sells in the order of 600 million litres of petrol per month.

Mr King—I should add that we are fully committed to the Australian government's program to steadily introduce biofuels into the mix, the total target for which is 350 million litres of biofuels blended into the petrol and diesel mix by 2010. Some of our initiatives are ongoing, such as the roll-out of E10 to an increasing number of sites in New South Wales and Queensland and to extend that.

We also sell biodiesel. Last week, at our Newcastle terminal, we launched what we call 'new generation diesel'—diesel blended with two per cent biodiesel. In fact, Deputy Prime Minister Vaile was at that launch. It is the first time that we have been able to offer a biodiesel mix to

general consumers as opposed to municipalities or major contracts. That is all part of our strategy to get biofuels accepted more by the public—to start in a small way and to build from that point. It is part of our strategy overall to meet the commitments that we made to the federal government for biofuels by 2010.

CHAIR—Thank you very much, Mr King, Mr Beattie and Mr Ridley-Smith. Your evidence has been very helpful indeed. If you want to make an additional submission, please send it to the secretariat in the usual fashion.

Proceedings suspended from 10.42 am to 11.03 am

JOHNSON, Mr Peter, Policy Adviser, Australian Chamber of Commerce and Industry**POTTER, Mr Michael, Director, Economics and Taxation, Australian Chamber of Commerce and Industry**

CHAIR—I welcome representatives of the Australian Chamber of Commerce and Industry, Mr Potter and Mr Johnson. If you wish to make a short opening statement, please do so. The committee has received your submission, No. 54.

Mr Potter—Firstly, the committee has received a large amount of evidence. We have not had an opportunity to look through it all in detail but I am happy to take any questions you have relating to any of the issues raised in the committee. Of course, as we have not gone through all of this evidence we might have to take some questions on notice. In relation to oil prices, subsequent to our submission prices have fallen a bit. I guess this emphasises the fact that we have to be careful to look at longer run movements in oil prices and not focus too much on short-run movements because you can be overwhelmed by thinking about what is happening in the short-run. For example, if prices have gone up the previous week you might think that the economy is going to be toast and if the prices have fallen we are all going to be fine, whereas in fact it is much more important to focus on long-run movements.

CHAIR—Indeed, I have been wondering aloud, Mr Potter, during the course of these hearings why everybody condemns the government when the price of petrol goes up but nobody congratulates the government when the price of petrol goes down.

Mr Potter—Indeed. Another point I want to make is that the amount of oil in Australia is running out. Some evidence has been put forward to this committee that Australia will not be able to produce much more oil. We do not have a particular position on that one; I just want you to know that we are aware of those arguments and there are particular issues about what that will do with our trade deficit. Again, that is not something we have a particular position on. One way of addressing the issue of fuel prices and a trade deficit is by promoting alternative fuels. There are arguments for and against the promotion of alternative fuels and we run through some of them in our submission.

With higher prices that have come about for oil recently the economy has not reacted as badly as it did in previous oil shocks and that is because the economy has become more flexible. We have had more than a decade of economic reform and that has meant that the economy has been more able to deal with price shocks. Of course there is another point which is that the economy is less oil dependent than it was in the seventies when we had major oil price shocks. I just wanted to mention one thing. In earlier evidence it was suggested that there should be some examination of quantity rationing. We are not keen on that; we think that the best way of rationing oil is through price rationing rather than quantity rationing.

On excise, we believe that the current system of excise is a poor way of targeting externalities generated by oil use and that there needs to be some reform to excise to minimise distortions and broaden the base. We do not support the reintroduction of excise indexation. I might note in passing that the Productivity Commission has released a draft report into freight pricing, which

we are aware of, but we have not analysed it in any detail. I will leave my opening comments at that.

CHAIR—Thank you very much, Mr Potter. ACCI's constituent organisations do not include any of the four oil majors, do they?

Mr Potter—Actually they do. A member of ours called the Oil Industry Industrial Association includes those companies. I would suspect, although I am not sure, that they are all members of state chambers of commerce, so they would be our members indirectly through those organisations.

CHAIR—What about Woolworths and Coles?

Mr Potter—Again, they are probably members of state chambers of commerce. They used to be members of the Australian Retailers Association but I believe that they are not now. I cannot speak confidently about Coles and Woolies.

CHAIR—What about the Australian Institute of Petroleum?

Mr Potter—They are not a member of ours.

CHAIR—Notwithstanding that there might be this derivative membership of your organisation of the oil majors through state chambers of commerce, you do not come here speaking as their business peak body, of course, do you?

Mr Potter—No, AIP is responsible for doing that. We try to take a broader view of these types of issues. The fact that we have a very broad membership means that on some issues we cannot take a position, whereas some other groups might take a position because they have a narrower membership.

CHAIR—Just one other thing: does your association have a view on ethanol and, in particular, what the government ought to do about encouraging or even mandating the admixture of ethanol?

Mr Potter—We have certainly considered this issue. Again, it is a bit hard for us to come to a definitive position on that because we have such a diverse membership—

CHAIR—Hence my question! If you do not have a definitive position just tell us.

Mr Potter—We do not have a definitive position saying it should or should not be mandated. Our submission runs through a number of very important issues that need to be considered when you look at incentives or mandating. We note that there are arguments on one side and arguments on the other.

Mr Johnson—I think, broadly, we are supportive of voluntary programs. We are supportive of consumer information as well as a strong dialogue with businesses when implementing these programs.

CHAIR—Lastly, before I hand the call to Senator Stephens, are you aware of any ‘verified’—by which I mean empirically supported—allegations of price collusion by the oil majors, coming to you through your constituent organisations?

Mr Potter—No. I know that the ACCC has done a fair bit of investigation of this—

CHAIR—Sure, and I am not suggesting that it would necessarily be your role to be the recipient of such complaints.

Mr Potter—Yes.

CHAIR—We have, during the course of these hearings, as you are probably aware if you have been keeping an eye on them, heard a number of assertions to that effect.

Mr Potter—Indeed.

CHAIR—None of the assertions, when tested, seems to have the benefit of empirical or evidential support but nevertheless there is a belief, I think, among many people, particularly in the motoring organisations, that this happens. I was wondering whether, from your particular vantage, you had been the recipient of any evidence or verified assertions to that effect?

Mr Potter—Our members have certainly not been complaining to us about that particular issue. I would suspect that they would probably be complaining to the ACCC.

CHAIR—Sure.

Mr Potter—Has the ACCC appeared before the committee?

CHAIR—It has and it is going to come back again.

Mr Potter—I suggest that they would be best placed to adjudicate between the differing claims on that particular issue.

CHAIR—Thank you very much, Mr Potter.

Senator STEPHENS—Thanks, gentlemen, for your submission. I want to pick up on a few issues in the submission but before I go to that can I ask, Mr Potter: does your organisation have a view about the increasing influence in the fuel markets of the supermarkets? What effect do you think their presence will have on competition in the longer term?

Mr Potter—We certainly do not have a formal policy on it. We have a general philosophy of supporting competition, and to the extent that the movement of supermarkets into the market is increasing competition then that is good. Again, the ACCC are probably the best ones to adjudicate that particular issue. They have certainly allowed the supermarkets to do their thing with those coupons you get when you buy things from a supermarket. I guess if they say that that is okay I will defer to their judgement. Peter, did you have anything to say on that?

Mr Johnson—No, I think that has been covered.

Senator STEPHENS—My question was really: does your organisation have a view about their market share and what that might do for competition in the longer term?—but that is fine. The committee has had some evidence about the possibility that one of the four majors could exit the fuel market. Have you any thoughts about that and what the implications might be for petrol pricing? Should the government be doing anything to ensure that we retain the presence of the current four oil majors?

Mr Potter—It would not be the end of the world if one of those were to leave the market. The number of firms in a market is not the goal; the goal is to retail fuel as cheaply and as efficiently as possible. It may be the case that reducing the number of retailers actually makes the market more efficient. Then again, it might make it less efficient. I guess the evidence on that is not entirely clear at this point. The government and parliament are looking at this oil code, which is an area where this will need to be looked at closely. We do not have a policy on those particular issues. In general, we say that there should not be special competition rules applying to oil refining or retailing. We consider that the general competition rules should apply across the whole of the economy and, in general, there should not be specific rules applying to the oil industry.

CHAIR—Mr Potter, is ACCI's position in relation to part IV of the Trade Practices Act the same as it was when I think you submitted to the Dawson review, and I know you submitted to this committee's hearings about three years ago into section 46 of the Trade Practices Act? Is what you said then still a full reflection of ACCI's current view?

Mr Potter—I think that is.

Mr Johnson—I believe there was a later inquiry by the Senate.

CHAIR—That is the second of the two inquiries I referred to. There was the Dawson inquiry and there was this committee's inquiry, which was limited to section 46.

Mr Johnson—As I recall, I think ACCI supported a large amount of the minority report.

Senator STEPHENS—Gentlemen, can we look at some of the issues you raise in your submission? On page 8 there is a section called 'Fuel taxes'. First of all you say you support reform of fuel taxes to enable better charging for infrastructure. What exactly are you advocating there?

Mr Potter—The idea is that the current system of having an excise on fuel is not a very good way of charging for infrastructure use. The fuel tax inquiry found that fuel taxes do not charge very well for infrastructure use or for externalities. We are advocating a movement away from using fuel tax as a rather blunt instrument for charging for infrastructure towards better systems for charging for infrastructure use. We did make a submission to the Productivity Commission's inquiry into freight pricing, which touches on this particular issue. When you are looking at competitive neutrality between road and rail it is important that you design the system so that each bit of infrastructure is being appropriately charged and one is not being overcharged or undercharged.

Senator STEPHENS—Having argued that point, you then talk in your submission about minimising distortions in the tax treatment. You make the point that environmental or regional considerations provide possibilities where a differential treatment may be appropriate.

Mr Potter—Indeed.

Senator STEPHENS—What kinds of things do you think could work there to meet that transparency?

Mr Potter—On environmental grounds you might argue that there should be lower taxes on fuels which are more environmentally friendly. This links back to earlier points about alternative fuels. If there are demonstrated environmental benefits from alternative fuels then there is a clear argument for providing lower taxes on those fuels. That is broadly the way government policy has worked so there is already that distinction. You could argue that fuel taxes should be lower in the regions. That is probably too hard to implement, though. The government had the Fuels Sales Grant Scheme designed to keep down the price of fuel in rural and regional areas, but most analysis showed that it was not hugely successful at keeping down fuel prices in rural and regional areas.

Senator STEPHENS—I am not trying to be argumentative, but you go further and say—

Mr Potter—It is always good to have our arguments drawn out.

Senator STEPHENS—You then make the point: ‘There should be no advantage provided to one form of fuel relative to another, unless there are specific public policy considerations that need to be addressed.’ Aren’t you trying to have it both ways here?

Mr Potter—No, I think it is actually making the same point in different ways. You do have different taxes where there are public policy considerations such as environmental or regional considerations. When there are environmental or regional reasons to have differential taxes of different fuels, then fine. But if there are not particularly good reasons for doing it, then perhaps there should not be differential taxes of different fuels.

Senator STEPHENS—Let us go to the second point on page 9, then, where you talk about minimising ‘the risk of unintended technological consequences of the adoption of differential fuel taxation’. As I was saying, you are trying to have your cake and eat it too, aren’t you? Just what kind of technological consequences are you thinking about?

Mr Potter—I should preface this by saying: all of these dot points were not written by me. They were written by a predecessor, so I am not completely cognisant of the reasoning behind some of these. On ‘technological consequences’, I would surmise that that is about trying to encourage the development of new alternative fuels—for example, hydrogen—and things such as hybrid cars, and not hinder their development. Peter, did you have any insight into that?

Mr Johnson—On the technology side, whilst biofuels may appear to be a good alternative at the moment we also have to look towards not just the supply of petrol but also the types of cars, and the engines that will be fitted to those cars, in the future. So we may be going towards the hydrogen economy. We may be looking at petrol-electric or fully electric cars and, to the extent

that we do, we will have to adjust our policies again in the future to adapt to the new technologies. So we have to be aware that it is not just on the fuel side of the equation but also on the demand side of the equation.

Senator STEPHENS—I really am not trying to be argumentative. On the one hand, on page 8 you argue that there should be simplification of the fuel tax arrangements and that we should not be adding complexity, and then you counter that by saying that we could be making considerations for all of these other points that you make. You then say, on page 9, ‘At this stage, ACCI is not calling for a reduction in fuel excise.’ What might be the prompt that would trigger your call for a reduction in fuel excise?

Mr Potter—I guess on this point we would be driven by our members. Our members have decided our tax reform priorities in those dot points on page 9. If the price of oil did continue to rise, then our members might come to us and say, ‘Let’s reorganise our priorities. Let’s make reduction in fuel excise a priority.’ I cannot surmise when our members would come up with that position, but I think that would be entirely possible if fuel prices were to, say, double from wherever they are at the moment.

CHAIR—And I take it your members do not support a carbon tax?

Mr Potter—That is correct. Peter, do you have anything you want to say on that?

Mr Johnson—No. We are against the introduction of an emissions trading scheme domestically.

Mr Potter—But is it correct that we would support a scheme if it were international?

Mr Johnson—Yes. There are a number of pillars that would have to be in place before we agreed to a domestic scheme.

Mr Potter—And I guess that that also relates back to the overall goal of excise. Is one of the goals of putting an excise on fuel to reduce carbon emissions? If that is the case, then it actually should be part of a broader system of addressing carbon emissions, and it certainly is not at the moment.

Senator PARRY—First of all, I will declare that I have a sympathy for chambers of commerce and industry. I am still a member of a regional chamber of commercial and industry and had five years as director of the Tasmanian Chamber of Commerce and Industry. I declare that upfront. However, like Senator Stephens, I got excited when I read pages 8 and 9 and went through some of those things. I have a couple of follow-up questions to the questions from Senator Stephens. On page 9, you say ‘ACCI supports reform on fuel taxes’. Then it moves on to the issue that Senator Stephens asked about. The first dot point says ‘Environmental or regional considerations’. Were you considering as part of that dot point the isolated areas—and I will use my own home state of Tasmania as an example, or indeed far North Queensland—where transportation issues or fuel represents an additional cost? Was that a focus or a thrust under that particular dot point?

Mr Potter—That certainly would be one area where you could examine differential fuel tax treatment. I would go back to my earlier point that the government did have—and I think it still operates but I am not sure—a fuel sales grants scheme and they are getting rid of it because it was not shown to be very effective. Basically, the evidence so far is not fantastically good for schemes reducing fuel prices in the regions. I just need to make it clear that we are not saying that you have to do this or that you cannot do this; we are saying you should do these things—give differential treatment on an environmental and regional basis—where it has been clearly shown that they can achieve the goals which are set.

Senator PARRY—The final dot point on page 8 says ‘there should be no advantage’. The last line states ‘and these are clearly articulated’. Are you inferring that nothing has been clearly articulated concerning use of other methods?

Mr Potter—I refer back to the government’s fuel tax inquiry, which pretty much indicated that with the current way that fuels are taxed it has not been clearly articulated why there are differential tax treatments. At the very start, why is fuel taxed at 38c per litre? There is no particular reasoning provided for why it is taxed at that particular level. There is no particular framework in which that has been set.

CHAIR—That is not quite right. It was not always 38c, was it? Thirty-eight cents is where it was at the time that the government decided to stop indexing it.

Mr Potter—Indeed.

CHAIR—It is not as if one day Mr Costello was sitting at home on an idle Saturday afternoon and said: ‘What will we make the fuel excise? I’ve got a good idea: let’s make it 38.1c a litre. That’s a nice round number.’ This is a figure that has been arrived at by its own internal logic over time.

Senator PARRY—It has history.

Mr Potter—We have arrived at it through history but not through any particular economic analysis—that is my point.

Senator PARRY—You could argue that with any tax in that sense.

Mr Potter—Yes, I guess you could. We have a general predisposition to seeing a more rigorous economic analysis being done of which taxes are higher and which are lower and which you cut and which you do not. We have a little bit of a concern that there is not a huge amount of that analysis done in the tax debate. We are sort of trying to inject a little bit more of that through this. Have I addressed your question or was there more you wanted me—

Senator PARRY—No, you have. In other words, there is nothing clearly articulated in ACCI’s mind concerning reasoning.

Mr Potter—Yes.

Senator PARRY—You have made a fair point.

Mr Potter—I take Senator Brandis's point, which is that you can go through a clear process of coming up with a number of 38c per litre but whether that is a sufficient explanation is not clear. That is a different question.

Senator MURRAY—Given the variety of people in Australia, I am quite sure that there would be a small group of people somewhere who subscribe to the Saturday afternoon theory.

Mr Potter—Yes, it is entirely possible.

Senator PARRY—It could have been the number of points Essendon had kicked at that particular point in time. Just expanding upon that issue, you have made no mention—I could not see any mention and correct me if I am wrong—about research and development and maybe tax incentive for research and development in the area of alternative fuels. What is ACCI's position on that?

Mr Potter—As far as I recall, the submission does not mention R&D. We have got a lot of detailed policies on R&D and innovation. I will let Peter speak to them.

Senator PARRY—In brief, would ACCI be supportive or would it have a view about having some incentive to encourage further R&D?

Mr Potter—On the tax front, we support an increase in the R&D tax concession back to the 150 per cent it was previously and an additional R&D tax concession for research that looks at means of reducing greenhouse emissions, so it could be linked in with that.

Mr Johnson—I think our major goal is to raise the R&D concession from 125 per cent back to 150 per cent. As long as the R&D programs are properly structured and subject to cost benefit analysis, we would make our decision based on that and certain policy objectives.

Senator PARRY—If you had to give us a very brief overview as to ACCI's position on fuel prices in Australia today, do you have a motherhood statement about fuel prices?

Mr Potter—That is a hard one to answer. I might reiterate some points that I made in my opening: first of all, we need to focus on what is happening in the long term, not the short term, with fuel prices. If you focus on the short term, you can have a lot of knee-jerk reactions like with the recent increase in prices to high levels. There was a lot of talk about excise reductions and then, of course, the fuel price came down and nobody was saying, 'Now we need to increase excise.' Look at the long term is one thing I should say

Another point is that government policy needs to be very cognisant of the changing availability of oil and alternatives. As I said, Australia is running out of oil domestically, and so we need to look at what we are going to do about that. It could be a viable option to do nothing, but I think most people have decided that that is not the right way to go and that the government does need to do some things. The two main things the government could do is encourage exploration in Australia and encourage alternative fuels. We do not say much about encouraging exploration in Australia—that is not really our area of expertise.

CHAIR—If it were, Mr Potter, you would be aware of the vast swathes of the tax act which are devoted to incentivising oil exploration in Australia.

Mr Potter—Taking that point on board, there is another point, which of course is that a lot of the oil industry has a special tax put upon it. They have got the PRRT, the petroleum resource rent tax, put on it, which is separate to those other concessions. There are things that are talked about—for example, flow through shares to enable shareholders to obtain use of the losses which occur at the early stages of exploration. As I said, those areas are not really our area of expertise, so I would not want to delve into them in too much detail. The other point to make is on competition. We generally support the broad competition rules being applied to oil and fuel retailing. I do not think there is anything particular that needs to be applied especially to the oil industry.

Senator MURRAY—If you were to apply Maslow's hierarchy to goods, you would probably stick fuel down the bottom as an essential need along with food and water, and there is consumer and political sensitivity as a result to an essential good. You repeat a graph, which is widely available—a table, I suppose, more than a graph—in figure 2 on page 5, and that illustrates that Australia's fuel price on a comparable Australian cents per dollar basis is much lower than other countries. So if I say to somebody, 'Australian taxes, excise and so on—the tax component of petrol price—is less than half of that of the Netherlands,' the consumer will typically say, 'I don't live in the Netherlands.'

Mr Potter—Yes, it is not much comfort to an Australian, is it?

Senator MURRAY—But from a government, an economist and a policymaker's perspective, the international precedent indicates there is more consumer tolerance for a higher price based on overseas experience than we might expect. My question really goes to the tipping point. Let me phrase it this way: when the Treasurer constructs his budget—and I will use round figures for illustrative purposes—he says, 'All right. I'm going to collect a billion dollars from the fuel tax component.' If the world price moves, as you know, this is a relative mark. So the return he gets from the fuel price moving lifts and he might end up with a billion and a half so, in other words, he has received a windfall profit. In current policy terms, that is repaid to consumers in some form—tax cuts somewhere or better service or something—it is put in the pocket as a surplus or it is spent on another purpose.

I am not suggesting it as a policy I subscribe to; I just want to test the viewpoint. There maybe a view in the community that at certain levels of price for fuel they need relief. The question is whether we should move to accept excise from a flat rate excise and whether that stepping should occur at what might be adjudged to be highly sensitive areas. Again, I will just select a figure out of the sky as an illustration. I might kick in the \$US120 per barrel and another one at \$US150 per barrel—that sort of thing. Is your chamber, in principle, supportive of flexible taxation response to price movements of that kind, a stepping or progressive excise? In this case it would be a reduction, of course, and not an increase.

Mr Potter—It would be hard for me to respond off the top of my head to that type of question. We always support tax reductions—I would say that—so the idea of a step rate would be fine but if the oil prices fell below a certain level the excise will probably go up again, so we might have a concern about that particular part of it. We certainly have not got a policy on that,

and so I cannot say definitively yes or no as to whether we would support it. If it were proposed—

Senator MURRAY—But you do not automatically rule it out, do you?

Mr Potter—Do not automatically rule it out; do not automatically rule it in either. I might take up one thing you said, which is about government revenues relating to higher oil prices. My understanding of the way it operates is that the federal government's excise is affixed, so the amount of money the federal government receives does not go up when the oil prices go up. In fact—

Senator MURRAY—But if you add the GST component it does.

Mr Potter—The GST does go up but that all goes to the states, so you could argue that the federal government goes backwards because people buy less fuel when the prices go up. The amount of fuel consumption goes down, so you could argue the excise collection goes down and the federal government could be behind. You could argue the state governments are ahead but, again, there is another complication, which is when people spend more on fuel they spend less on other things. So you would probably have to address this one to the state governments, but I would suspect they would not be getting a vast amount of extra money.

Senator MURRAY—I understand that and it is a good point you make, but the point I make, of course, is that the consumer does not distinguish between that.

Mr Potter—Absolutely.

Senator MURRAY—They just say, 'This is the tax component; the overall amount has increased. I'm under stress; give me back some.'

Mr Potter—Indeed.

Senator MURRAY—My question to you is: where is the tipping point at which you should consider that? The point you make is that it may have to be a state decision not a federal decision, which makes it more complicated.

Mr Potter—It is extremely difficult to change the GST rate. It would have to be a federal government decision to reduce the excise. They would not be getting a particular windfall when the fuel prices go up, so they would have to provide that excise reduction from some other source—for example, a reduction in the surplus, deferring other tax cuts or deferring spending. Of course, all of those have particular costs which you would need to take into account.

Senator MURRAY—In my next set of tax questions I want to make it clear that I am not a supporter of taking GST off fuel. Having put my position on the table, I nevertheless want to test a proposition. People argue that a tax on a tax is not justified as a public policy matter. Frankly, it depends on the circumstance, but commonly the GST is always a tax on a tax because, if you take any final good or final service, included in that final good or service is the calculation the company makes with respect to what corporate tax it will pay. That is within its margin. Built in there are state taxes such as payroll taxes. All sorts of state, territory and federal taxes are set into

what the company or the business decides as a final price for its good or service provided. Therefore, to my mind GST is always to some extent a tax on tax. Nevertheless, it is a very common statement—talkback radio, letter writers and commentators effectively argue that fuel should be GST-free, like health and educational goods. What is the opinion of the chamber on that argument?

Mr Potter—I think there would be a major problem with doing that. I would say one thing first, and that is that of course we would always be supportive of tax cuts, so if you reduce the tax on fuel that is good. But the important problem with making fuel GST-free is that that would have absolutely no effect on the price of fuel purchased by business. Businesses can claim an input tax credit for all the GST, so effectively they get a 10 per cent reduction in the cost of fuel. If you made fuel GST-free, of course it would reduce the price for the final consumer but it would keep it exactly the same for business. I am not sure that that is a particularly good public policy result.

Senator MURRAY—I agree with you, but I want to know why you think that.

Mr Potter—I might just talk about the admin. That would add administrative complexity, of course. We and businesses generally argued at the time of the introduction of the GST that it should be applied as broadly as possible. If you made fuel GST-free, that would be winding back on that particular position that we took and so we would not be supportive of that from an administrative point of view. It would cost a lot of money too. We think that if you want to do something, it would probably be better to look at the excise rather than at the GST. If you take a different perspective on it, when the government introduced the GST it actually reduced the excise by what they calculated to be the effect of the GST anyway. They did not get it quite right, and that is why they had to reduce it by 1.5c a litre later. But, taking that all into consideration, the reduction in 2000 plus the reduction in 2001 and then the abolition of indexation, the price of fuel, including the tax, is probably lower now than it would have been in the absence of the introduction of a GST.

Senator MURRAY—Earlier you made the remark that you would, as a matter of course, support any tax cuts. I want to test that. As an economist, you would be familiar with the terminology ‘sin taxes’.

Mr Potter—Yes.

Senator MURRAY—There is some substantial and very authoritative literature that has assessed the price effects on what may be regarded as antisocial behaviour, where elasticities and substitutions occur and what the effects are of price movements—and that is with respect to what are traditionally regarded as sin goods, such as gambling or alcohol. By raising the price to a certain level you hope to restrain consumption and there is no doubt that that is the effect. To use other terminology, that takes into account externalities. In view of the current interest in climate change and in restraining the use of fossil fuels and the negative effects of that—and we are all aware of the positive effects—there is probably some public policy interest in actually restraining consumption where it is excessively discretionary and results in what we might call unnecessary use. In that terminology, maintaining a relatively high fuel price is regarded as a good thing. I am not sure at what level that concept applies, and that is where the difficulty

applies. But, to some extent, a higher fuel price is welcomed by those with great environmental concerns.

Mr Potter—Yes. First of all, we acknowledge that there are greenhouse gas problems that need to be addressed, and Peter might want to make further comments about this. The question is how you do it. If you wanted to do a domestic emissions tax, you would have it at a much lower rate on fuel and you would put a higher one on other things, particularly coal. The current system of taxing fuel does not really fit very well with the idea of a domestic emissions tax, but then, of course, the much broader question is: do we have or want a domestic emissions tax? We certainly oppose the idea of a domestic emissions tax unless certain conditions are met, which Peter can speak on. I go back to your point about sin taxes. I am fully aware of that and fully take that on board. Perhaps I need to amend my earlier point about supporting any tax reduction by saying there might be some taxes which you should not reduce, because they are designed for goals other than revenue raising.

Senator MURRAY—The reason I have raised this is not out of some kind of obtuse interest, but I think that, in your response, you have made a very interesting point. Unfortunately, I am not aware of what the fuel tax inquiry has found or looked at or whatever, but it seems to me that petrol taxes and fuel taxes for transportation have tended to be looked at in isolation as a policy contributor to better usage—if I can loosely define it as that—in the whole area of emissions, which is exactly the point you make. You make the point that it has to be considered in terms of how it contributes as part of a total view on how coal affects our emissions, how other forms of energy production affect our emissions, how transportation affects our emissions and so on.

The question is whether the committee should recommend to the government that it look at fuel excise not just within the range of transportation fuels—‘Here are the alternative fuels, here are the additives, here is the diesel fuel mix, here is the business mix, here is the consumer mix’—but also with respect to how it fits in with the government’s announced overall policy intent of trying to reduce emissions. Is that something the committee should say to the government or should we just let it pass by as something that is obvious?

Mr Potter—Government policy making has to look at the broader issues. You cannot just have silos in which you look at policy; you have to be aware of its broader consequences. You cannot just look at fuel taxes in isolation; you have to look at their interaction with other policies—for example, climate change policies.

Mr Johnson—Looking at the issue of climate change with regard to this inquiry would probably broaden it substantially. There may be better forums in which to undertake that sort of analysis.

CHAIR—Thank you, Mr Potter and Mr Johnson.

Committee adjourned at 11.51 am